

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 17934
[Redacted],)	
)	DECISION
Petitioner.)	
_____)	

On January 26, 2004, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayer), proposing income tax, penalty, and interest for the taxable years 1998 through 2002 in the total amount of \$16,490.

On February 9, 2004, the taxpayer, through his representatives, filed a timely appeal and petition for redetermination. The taxpayer's representatives requested a hearing, which was held via a telephone conference call on May 5, 2004. The Tax Commission, having reviewed the file, hereby issues its decision.

The taxpayer is a [Redacted] citizen living in [Redacted]. He has investments in several states of the United States. The taxpayer is the sole member of an all Idaho Limited Liability Company (LLC), [Redacted]). [Redacted]'s business was real estate development in Idaho. [Redacted] was formed in June 1997.

[Redacted] filed partnership returns with the state of Idaho for the taxable years 1998 through 2002 reporting its ordinary income/loss and portfolio income/loss as being 100% apportioned to Idaho. However, the taxpayer reported only [Redacted]'s ordinary income/loss on his Idaho individual income tax return. Since LLCs are flow-through entities, the Income Tax Audit Bureau (Bureau) adjusted the taxpayer's Idaho returns to include [Redacted]'s portfolio

income/loss. The Bureau sent the taxpayer a Notice of Deficiency Determination, which the taxpayer protested.

The taxpayer stated the portfolio income was interest income that was not earned in Idaho or derived from sources within Idaho. The taxpayer stated he deposited \$970,000 in a [Redacted] bank and those funds were used for various business activities. He said a large portion of the funds was used to complete the [Redacted] development; however, there was never an accumulation of funds derived from the Idaho investment to earn interest. The taxpayer stated the account was set up to keep the necessary cash surpluses to support his investments in [Redacted] as well as the Idaho investment.

The Bureau referred the matter for administrative review, and the Tax Commission sent the taxpayer a letter giving him two options for having the Notice of Deficiency Determination redetermined. The taxpayer's representatives requested a telephonic hearing, which the Tax Commission granted. During the hearing, the representatives stated the taxpayer had investments in an Idaho partnership prior to developing or creating [Redacted]. In 1997, the taxpayer advanced \$970,000 to his U.S. investment manager for the taxpayer's U.S. investments. The funds were placed into a money market account given the name of [Redacted] and the federal tax identification number of the taxpayer's LLC. The representatives stated the account was set up this way because the taxpayer had a foreign tax identification number, which creates problems with computer systems. They also stated that [Redacted] was the only entity in which the taxpayer was the sole owner and where he had total control over the account.

[Redacted] purchased Idaho property in 1997 and developed the property in 1997 and 1998. All the funds for developing the property came from the money deposited into the money market account. The representatives stated that all the money market accounts funds were

invested in the Idaho project. They stated that [Redacted] did not contribute to the account balance of the money market account. They said anything [Redacted] deposited into the money market account was a recovery of the investment put into the Idaho project. The representatives stated all the money from the sale of the developed lots went into the money market account. [Redacted] did not have a separate account.

The representatives stated the money market account was reported on [Redacted]'s return because they needed to report the activities of the account and it had the federal identification number assigned to [Redacted]. The representatives said the use of [Redacted]'s name and its tax identification number was an error. They now believe they should have set up the account independently of [Redacted].

LLCs can be treated as corporations, partnerships, or as disregarded entities if the LLC has a single member. In this case, [Redacted] elected, through "check-the-box", to be treated as a partnership. Therefore, all the tax attributes, income or loss, gains, credits, etc. are flowed through to the members of [Redacted]. On [Redacted]'s Idaho income tax returns, [Redacted] reported ordinary income in all the years but 2001 and portfolio income every year. The returns reported that [Redacted] was a 100% Idaho LLC. Since [Redacted] is reported as having 100% of its activity in Idaho, 100% of its income is reportable to Idaho.

Idaho Code section 63-3026A(3)(a) states that, for nonresident individuals, income shall be considered derived from or relating to sources within Idaho when such income is attributable to or resulting from business conducted or carried on in Idaho and includes the distributive share of partnership income and deductions. The portfolio income generated from the money market account was reported as income of [Redacted]. The account appeared to be set up and used as a working capital account for [Redacted]; funds were drawn out of the account for [Redacted] and

[Redacted] deposited funds back into the account. It appears the money market account was an integral part of the business operations of [Redacted].

The taxpayer and/or his investment manager made a choice on how the money market account was established. Now the representatives would like the Tax Commission to overlook the way the account was set up and consider it the way it could have been created for the taxpayer. The U. S. Supreme Court addressed this request as follows:

This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, Higgins v. Smith, 308 U.S. 473, 477, 60 S.Ct. 355, 357, 84 L.Ed. 406 (1940); Old Mission Portland Cement Co. v. Helvering, 293 U.S. 289, 293, 55 S.Ct. 158, 160, 79 L.Ed. 367 (1934); Gregory v. Helvering, 293 U.S. 465, 469, 55 S.Ct. 266, 267, 79 L.Ed. 596 (1935), and may not enjoy the benefit of some other route he might have chosen to follow but did not. 'To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty.' Founders General Corp. v. Hoey, 300 U.S. 268, 275, 57 S.Ct. 457, 460, 81 L.Ed. 639 (1937); Television Industries, Inc. v. Commissioner of Internal Revenue, 284 F.2d 322, 325 (C.A.2 1960); Interlochen Co. v. Commissioner of Internal Revenue, 232 F.2d 873, 877 (C.A.4 1956). See Gray v. Powell, 314 U.S. 402, 414, 62 S.Ct. 326, 333, 86 L.Ed. 301 (1941).

Commissioner v. National Alfalfa Dehydrating and Milling Company, 417 U.S. 134, 149 (1934).

Echoing the same sentiment, the Tax Court of New Jersey stated, in part:

General Trading Co., Inc. v. Taxation Div. Director, 83 N.J. 122, 416 A.2d 37 (1980), dictates precisely the opposite result: if the tax is due, what *might* have been done for a different tax result is of no consequence. The legal principle which governs this case is the same as in *General Trading*, in which Chief Justice Wilentz wrote:

In our view the legal principle which governs this case is that a voluntary business decision "is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred." *Commissioner v. National Alfalfa Dehydrating*

and Milling Co., 417 U.S. 134, 148, 94 S.Ct. 2129, 2137, 40 L.Ed.2d 717, 727 (1975).

This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not . . . , and may not enjoy the benefit of some other route he might have chosen to follow but did not. "To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty." [*Id.* at 149, 94 S.Ct. at 2137 (citations omitted)]. [*Id.* at 136-137, 94 S.Ct. at 2131]

In *General Trading*, a corporation authorized the issuance of 10 million rather than 100,000 shares of stock, with no apparent business purpose. This action resulted in a deficiency assessment of over \$26,000. In holding that the taxpayers must suffer the consequence of their inadvertence, the court said:

That the stockholders and officers of General Trading may not have given a minute's thought to the tax consequences of their decision is irrelevant to the question of liability under the Statute. [*Id.* at 134, 416 A.2d 37]

This court has also held that "a contractual obligation which now appears to be less advantageous than originally anticipated . . . cannot be the basis for nontaxability." *Atlantic City Airlines, Inc. v. Taxation Div. Director*, 4 N.J.Tax 97, 105 (Tax Ct.1982), citing *General Pub. Loan Corp. v. Taxation Div. Director*, 13 N.J. 393, 99 A.2d 796 (1953).

The court sympathizes with plaintiff's claims that the lease was approved by the Board of Public Utility Commissioners of the State of New Jersey; that it would not have entered into the lease if it expected that the property would be taxed, and that the lease was entered into to reduce its costs, to reduce its rate base and, hence, to reduce the cost of electricity to the consumer. However, such arguments are more appropriately made to the Legislature than to this court. *MacMillan v. Taxation Div. Director*, 180 N.J.Super. 175, 434 A.2d 620 (App.Div.1981), *aff'd o.b.* 89 N.J. 216, 445 A.2d 397 (1982).

Atlantic City Electric Company v. Taxation Division Director, 5 N. J. Tax 15, 23-24 (1979).

The money market account was set up, structured, and reported as being part of the business of [Redacted]. The taxpayer has provided nothing to show that the account was not an integral part of [Redacted]'s existence. Therefore, the inclusion of the portfolio income as a flow-through item to the taxpayer's Idaho individual income tax return is affirmed.

WHEREFORE, the Notice of Deficiency Determination dated January 26, 2004, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1998	\$4,024	\$0	\$1,435	\$5,459
1999	6,290	0	1,756	8,046
2000	1,126	0	261	1,387
2001	10	0	2	12
2002	1,621	0	147	<u>1,768</u>
			TOTAL	\$16,672
			PAYMENTS	<u>9,130</u>
			TOTAL DUE	<u>\$7,542</u>

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is included with this decision.

DATED this ____ day of _____, 2004.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2004, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]

[REDACTED]

[REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
